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NO. 791

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

BERNARD P. McDONOUGH, Petitioner

v.

JOHN BERSHAD, Respondent

PETITIONER'S REPLY BRIEF

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INDEX

	PAGE
Preliminary Statement	1
Jurisdiction	2
Conflict	4
Constructive Ownership	6
Securities and Exchange Commission Forms	8

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Preliminary Statement

Initially, petitioner invites the Court's attention to the many references in respondent's brief to "an alleged or so-called option" and "a facade of option" purportedly erected by the McDonoughs and the representatives of Smelting to conceal a sale, as though constant repetition of this theme establishes the existence of such a scheme, where the evidence is entirely to the contrary. This theory first advanced by respondent in his complaint and constantly alluded to in pleadings and briefs, was never established. Respondent failed to produce any evidence — not a scintilla — that the parties to the option had entered into any such scheme. All the evidence was to the contrary.

This case should not be colored by any such artfully contrived background, although it is clear that the

frequent references were made in an effort to prejudice the petitioner's case.

Jurisdiction

Respondent's contention that petitioner, as an insider, has no standing to raise the jurisdictional question does not meet the mandate of *McNutt v. General Motors Acceptance Corporation*, 298 U.S. 178 (1936). Chief Justice Hughes there authorized a challenge to jurisdiction at any stage of the case by parties or by the Court on its own motion. Further, *McNutt* holds that the burden of proof is on the plaintiff to establish jurisdiction. Manifestly, these fundamental requirements cannot be set at naught by the mere allegation that petitioner was an "insider" and without standing to raise the jurisdictional question under *Grossman v. Young*, 72 F.Supp. 375 (D.C.N.Y. 1947).[1]

Two suits earlier brought in New York against Cudahy by two other stockholders, which were dismissed for lack of jurisdiction, cannot serve to fill a jurisdictional void. Jurisdiction cannot depend upon other litigation in a separate forum and to so contend is a *non sequitur*. If the two dismissals, which are out-

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1. The peculiar facts in *Grossman* involving fraud, concealment and delay prompted the Court's observation that the requirement of a demand was for the benefit of the corporation not the insider. A demand was duly made by the plaintiff before a suit in that case and the issuer publicly stated that a suit would not be brought. The District Court held for the purposes of the motion to dismiss that the plaintiff was not required to await the expiration of the 60-day period after demand in view of the facts and the possible bar of the statute of limitations.

side the record of this case, support anything, they support petitioner's contention that jurisdiction was lacking.

Respondent's statement that "The courts below properly took judicial notice * * * of the Abrams and Silverman suits" (Respondent's brief, page 8) is not borne out by the opinions rendered by either the District Court (Appendix A) or the Court of Appeals (Appendix B) as no reference was made in those opinions to the New York suits or to the proposition that they satisfied the jurisdictional deficiency in the present suit.

Congress was performing its legislative function in conferring jurisdiction on federal district courts to entertain suits to recover short-swing profits under Section 16(b) where none existed before (*Dottenheim v. Murchison*, 227 F.2d 737 (5th Cir. 1955), cert. denied, 351 U.S. 919) and had an absolute right to condition a stockholder's right to sue in the manner legislated. These jurisdictional requirements were prescribed to be met and not waived or diluted by judicial construction with its attendant burdens being imposed upon the already heavily burdened federal district courts.

Respondent's contention that compliance with the statutory requirement that a request be made of the issuer is waived if such request would be futile runs counter to the plain language of the statute and should not be sustained. Congress presumably did not use meaningless language in conferring jurisdiction on the courts and to attribute such an intention to the Congress is violative of the fundamental rules. "No rule of statutory construction has been more definitely stated

or more often repeated than the cardinal rule that significance and effect shall, if possible, be accorded to every word * * *." *Ex parte The Public Nat. Bank of New York*, 278 U.S. 101, 104 (1928).

The simple untarnished fact is that respondent did not comply with the jurisdictional requirements of the statute and the suit should be dismissed under the holding in *McNutt, supra*. Finally, there was no evidence that demand upon Cudahy would have proved futile.

While a liberal rule has been applied in stockholders' derivative suits, it was pointed out in *Dottenheim v. Murchison, supra*, at page 738, that "The statute here involved, while similar in some respects to a stockholder's secondary or derivative right, is not such a right at all. It is in reality a primary right. This is so because the statute which creates it makes it so."

Conflict with Blau v. Lehman

Respondent does not answer Point 2 made in the petition (pages 11-14), where it was pointed out that the decision of the court below conflicts with this Court's decision in *Blau v. Lehman*, 368 U.S. 403 (1962). Respondent states at page 9 of his brief that petitioner's citation of *Blau v. Lehman* and the cases at page 12 of the petition dealing with *"true options"* have no relevance and that the arguments advanced at pages 12 to 14 completely miss the point.

This attempt to avoid any discussion of one of the main points by the simple expedient of saying that *Blau v. Lehman, supra*, the only pertinent Supreme Court decision on Section 16(b), and the cases dealing with true options are not relevant begs the question. It shows

the respondent's unwillingness or inability to come to grips with the petitioner's contention that the decision of the court below conflicts with this Court's decision in *Blau v. Lehman* because it greatly enlarges the scope of Section 16(b) to include an option along with "a purchase and sale" without congressional authority. Because the respondent is unwilling to discuss the point, it is respectfully suggested that Point 2 of the petition be considered in connection with the respondent's attempt to bypass this Court's decision and our reliance thereon.

Respondent's failure to reply to the actual proposition raised by the petitioner's brief is illustrated by his refusal to rebut the following statement from page 13 of petitioner's brief:

> "In order for the Court of Appeals to adopt the decision of the District Judge, it was necessary that it ignore the option agreement; the uncontradicted testimony of the parties thereto that an option was intended; the uncontradicted testimony that Smelting sought an option for as cheap a price as possible (55a), and that the purpose of the option was to give Smelting an opportunity to study the operations and financial condition of Cudahy (59a, 60a). The decision of the Court of Appeals must have been premised upon the affidavit of the attorney for the plaintiff which was admittedly made without personal knowledge and was argumentative rather than factual."

Constructive Ownership

Respondent's efforts to meet the problem of due process with regard to Alma McDonough's stock have driven him to construct a theory of constructive ownership which is without merit.

In his efforts he first states at page 11 of the brief that the Circuit Court pointed out that husband and wife transactions were rife with "the potential of sharp practices." This quote from the Circuit Court's opinion is false and misleading as the Court did not refer to husband and wife transactions at all, much less as being rife with the potential of sharp practices.

With this erroneous introductory note, which was evidently designed to create the impression that the McDonoughs engaged in sharp practices, respondent then states that Mrs. McDonough did not participate in either the original purchase of the stock or the negotiations for the option. This is another erroneous and misleading statement as the record shows that Mrs. McDonough participated in and signed the option agreement (30A, 31A) and executed an affidavit in which she stated that she was the owner of 141,363 shares of Cudahy common stock involved in the option (35A).

Next, respondent relies upon SEC Release 34-7793 (31 F.R. 1005) to support constructive ownership. This also fails. That release merely sets forth guidelines to be followed in reporting securities in which a husband or wife might have a beneficial interest. It does not purport to pass judgment on the question of beneficial interest or ownership for the purposes of Section 16(b).

Indeed, it calls upon the judicial system to do so in the following language:

> "The final determination of the existence of beneficial ownership under Section 16 is, of course, a question to be determined in the light of the facts of the particular case. It should be noted that although a report includes the holdings of other members of the family of the person filing reports, a person may avail himself of the privilege granted by Rule 16a-3 and disclaim that such report is an admission of beneficial ownership of any securities included in the report."

Mrs. McDonough's profits were her own, not her husband's, and not subject to forfeiture under Section 16(b). The evidence of record shows that she was the sole owner of her stock, which was purchased with her funds and which shares were represented by duly issued certificates. She was neither officer, director nor ten per cent shareholder and was outside the extraordinary liability imposed by Section 16(b). *Blau v. Lehman, supra.*

As Mrs. McDonough owned the stock in her own name and right, the taking of her property was a denial of due process. The Fifth Amendment guarantee of due process is a touchstone of the judicial system and whatever else may be uncertain about the scope of due process, it does bar the taking of one person's property and giving it to another contrary to settled usages and modes of procedure.

There is no question but that the judgment in this case takes Mrs. McDonough's property without due process of law as she was not a party to the suit and

was denied the fundamental right to a hearing before her property in the form of profits could be taken away from her. As her profits were not forfeited under the statute, there was no authority under which her property could be taken from her and her husband held liable therefor on the theory that her profits were forefeited along with his. As far as the record reveals, no attempt was made to join her as a party. Instead, she was completely bypassed. As a matter of fact, the taking of her property in the manner in which it has been accomplished here is a clear violation of not only constitutional but procedural due process for which the judgment should be set aside in order to prevent a grave miscarriage of justice.

Securities and Exchange Commission Form 3 and Form 4

Respondent's references on page 5, paragraph (f) to the fact that on or about July 20, 1967, Smelting filed with the Securities and Exchange Commission, SEC Form 3, Respondent's Appendix 1 (page 15), as evidence that Smelting became the beneficial owner of the stock at that time, is misleading. The Form 3 contains the following explanation of the reason for filing the form and the fact that Smelting disclaimed any beneficial ownership in the stock based upon the option:

> "On July 20, 1967 United States Smelting Refining and Mining Company acquired an option to purchase 272,000 shares of common stock of Cudahy Company.
>
> "The filing of this statement shall not be construed as an admission that United States Smelting Refining and Mining Company is, for the purpose

of Section 16 of the Securities Exchange Act of 1934, the beneficial owner of the 272,000 shares of common stock covered by the option."

Respondent makes no reference to SEC Form 4, which was filed by Smelting October 4, 1967, (Plaintiff's Exhibit 12) showing the date of the sale of Cudahy stock and its acquisition by Smelting as being September 27, 1967, the date upon which the option was exercised by Smelting. These were official forms and prove the fact of the date of the sale, which occurred after the six month's statutory period had expired. Furthermore, these forms were executed contemporaneously with the transactions, attesting to their authenticity and accuracy and should not be subject to alteration at this late date in order to support an action of this character.

Respectfully submitted this 8th day of December, 1970.

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